

Internal Revenue Service
memorandum

TL-N-1572-89

CC:TL:TS/LJBYUN

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to: District Counsel, Los Angeles W:LA
Attn: Joyce Sugawara

from: Assistant Chief Counsel (Tax Litigation) CC:TL

subject: Scar Issue: [REDACTED]

Docket No. [REDACTED]

This memorandum is in response to your request for technical advice regarding a Scar issue in the above-mentioned case.

ISSUE

Is the statutory notice of deficiency in this case valid under Scar v. Commissioner, 814 F.2d 1363 (9th Cir. 1987)?

CONCLUSION

This case should be conceded. Because we do not have the [REDACTED] return, it cannot be determined whether the right adjustments were made (i.e., right shelter and right amount). However, even if it is assumed that the right adjustments were made, a "plug rate" was used. Furthermore, even though the transcript of account was available at the time the statutory notice was issued, not all of the relevant information from the transcript of account was used in determining the deficiency.

FACTS

A statutory notice of deficiency was issued to the [REDACTED] on [REDACTED], for the tax year [REDACTED]. The statutory notice specified a deficiency in the amount of \$ [REDACTED] arising from disallowed losses in the amount of \$ [REDACTED] from [REDACTED] and \$ [REDACTED] from [REDACTED]. The statutory notice used the "smoking gun language" of Scar ("In order to protect the government's interest and since your original income tax return is unavailable at this time, the income tax is being assessed at the maximum rate of [REDACTED] %."). The administrative file contained a transcript of account for the [REDACTED] tax year as of the 9th week of [REDACTED]. It appears that the only information taken from the transcript of account was the tax shown on the return. No information showing taxable income or AGI was used.

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The administrative file contains a K-1 for [REDACTED] showing a loss of \$ [REDACTED]. It does not contain a K-1 for [REDACTED] or the [REDACTED] return.

DISCUSSION

Since this case lies within the Ninth Circuit, we recommend that the case be conceded based upon the Scar holding. Although the Service does not agree with the Ninth Circuit's "substantive content" standard for testing the validity of deficiency notices under section 6212(a), as a result of the uncertainty of the scope of Scar, the Service wants to restrict the impact of the decision to the facts in that case. Therefore, the Service will not relitigate the "determination issue" on facts not materially different from Scar.

It is our position that we do not need to have the original return to make a determination. Instead, we can rely on taxpayer return information found in the transcript of account, as well as relevant K-1s. Since it is our position that we can rely on the Service's data bases to make a determination, it is imperative that we actually use the information from the transcript to make the determination, as compared to "backing into" the deficiency. If we use the amount shown for AGI or taxable income from the transcript, as well as the amount shown for tax on return, plus the other information regarding the adjustments, a proper determination can be made.

As mentioned above, the administrative file does not contain a K-1 for [REDACTED] and the [REDACTED] return. Without these, we are unable to determine whether the right adjustment was made with respect to [REDACTED]. Furthermore, without the return, it cannot be determined whether the [REDACTED] actually claimed the entire amount of the losses (\$ [REDACTED]) reflected in the statutory notice.^{1/} However, even assuming that the right adjustments were made, the fact remains that the deficiency was "backed into." The Service failed to use all the relevant information that was available when the determination was made. Moreover, the "plug rate" of 50 percent was incorrectly applied. This is evident because based on the transcript of account, the

^{1/} We note that if the only problem with the statutory notice was that the [REDACTED] actually claimed less than the amount reflected on the K-1s, we would defend it since it is our position that we can rely on return information such as K-1s. We want to be able to show that some reasonable nexus existed between the disallowed deduction and the return. It is our position that information from the Service's data base records of taxpayer's return as well as third party information (such as a copy of K-1) raises a reasonable inference that the deduction was claimed.

highest rate of tax which would have been applicable to the taxpayers as a result of the disallowance would have been 49 percent. That is, even if it is assumed that the [REDACTED] claimed the entire \$ [REDACTED] of losses, adding that amount to \$ [REDACTED] (the amount shown as the taxable income in the transcript) would result in a new taxable income of \$ [REDACTED]. For [REDACTED], the correct rate for married couples filing joint returns for taxable income over \$60,000 but not over \$85,600 is 49 percent.

Because, in this case, we did not use all the relevant information (i.e., such as taxable income or AGI) that was available when the deficiency was determined, it does not meet the requirements for application of our theory that a proper determination can be made by using relevant information from our data bases. Therefore, this is not the type of case that we want to defend in the Ninth Circuit.

Based upon the above facts, we do not recommend defending this case. Should you have any further questions regarding this matter, please contact Lisa Byun, Tax Shelter Branch, at FTS 566-3289.

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